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BEFORE THE
FEDERAL COMMUNICATIONS COMMISSION
WASHINGTON, D.C. 20554

In the Matter of	)	FCC 93-177
	)	
Implementation of Sections of the Cable Television Consumer Protection and Competition Act of 1992	)	MM Docket No. 92-266
	)	
Rate Regulation	)	

To the Commission:

MICHIGAN COMMUNITIES' OPPOSITION AND RESPONSE TO PETITIONS FOR RECONSIDERATION AND PROOF OF SERVICE

Several franchising authorities in Michigan ("Michigan Communities") submit this opposition and response to the petitions for reconsideration filed by the National Cable Television Association, Community Antenna Television Association, Coalition of Small System Operators, Local Governments (NATOA) and King County, Washington et al. Michigan Communities address the following issues so as to have meaningful rate regulation under the Cable Television Consumer Protection and Competition Act of 1992 ("The Act" or "1992 Act"):

-- The incorrect and misleading information being provided to franchising authorities by cable operators such as Continental Cablevision require the Commission to allow municipalities/the FCC to initiate cost of service regulation or at minimum allow such regulation to be used whenever cable operators have attempted to evade the Act and its rules, such as by providing incorrect or misleading information to franchising authorities or this Commission.

-- The incorrect and misleading information being provided by operators such as Continental shows the need for the Commission to change its rules which allow cable operators to raise their rates up to the benchmark if they are currently below the benchmark to instead allow franchising authorities/FCC to reduce rates to the lower of current rates or the benchmark.

-- The need for clarification of the Commission's ruling that rate regulation agreements are invalid, such as due to statements by cable operators and others that communities can now validly enter into rate regulation agreements (but are severely hindered in settling rate cases).

-- Oppose the cable operators' attempts to turn the Commission's "price cap" regulation into "price floor" regulation by allowing (for practical purposes) all costs, including all fixed costs, to be added on to the benchmark amount.

-- Oppose different, more lenient rules for small cable systems.

-- Respond to misstatements and substantial factual errors contained in the attacks by NCTA on this Commission's use of data from municipal cable systems in setting its benchmarks, in particular its use of data from Paragould, Arkansas.

Michigan Communities bring to this Commission two perspectives that are critical for the effective implementation and enforcement of the Act. These are as follows:

-- Feedback on what cable operators are telling municipalities about this Commission's May 3 Order. Such feedback should help the Commission, in particular by showing how the cable operators are (a) utilizing ambiguities in the Commission's Order in ways that are inappropriate, and (b) in other cases providing information on the May 3 Report and Order which (at best)

is misleading and in some cases is the opposite of what this Commission has ruled.

-- Michigan Communities include many small communities with populations in the 700 to 18,000 range. By number, most of the franchising authorities in the United States are small and are in this size range. This Commission has to be sensitive, not only to small cable operators (who are complaining about the May 3 Report and Order), but to small franchising authorities and customers served by small systems. This filing assists in this regard.

I. MICHIGAN COMMUNITIES' REPRESENTATIVES

All communications and correspondence relating to this matter should be directed to the following representatives of Michigan Communities; Mr. John W. Pestle, Varnum, Riddering, Schmidt & Howlett, 333 Bridge Street, N.W., P.O. Box 352, Grand Rapids, Michigan 49501-0352; Mr. Thomas O'Malley, Steering Committee Member, Michigan C-TEC Communities, City of Coopersville, 289 Danforth Street, P.O. Box 135, Coopersville, Michigan 49404-0135.

II. MICHIGAN COMMUNITIES' INTEREST IN THIS MATTER

Michigan Communities are the franchising authorities[1] for their respective area. They are all in Michigan and include the City of Kalamazoo, City of Walker, Ada Township, Grand Rapids Charter Township and thirty-five communities who are provided with cable service by C-TEC Cablevision of Michigan or its affiliates ("C-TEC"). Such "C-TEC Communities" are generally small, ranging in size from 700 to 18,000 people and are

[1] For simplicity, the term "franchise" is used herein as defined in the 1984 Federal Cable Act to mean the authorization given the cable operator, whether denominated as a franchise, license, consent agreement or otherwise.

mainly located in rural areas.[2] C-TEC, the cable operator which serves these communities, is a multiple system operator and serves approximately 140,000 subscribers in Michigan on 70 different systems involving franchises from over 400 local units of government.

III. SPECIFIC ITEMS

A. Cost of Service/Attempted Evasions: Michigan Communities respond to the Petition for Reconsideration by King County, Washington, et al by supporting and commenting on King County's position that the FCC's rules do not go far enough and should be modified to permit franchising authorities and the FCC the discretion to initiate cost of service regulation.

Michigan Communities support this position for the reasons set forth by King County. It would allow an appropriate reduction in rates so as to benefit consumers. Michigan Communities respectfully suggest the following middle ground, namely to allow franchising authorities or this Commission on their own to initiate cost of service based regulation, but limited to those situations where cable operators have attempted to evade the rate regulation provisions of the Act or rules thereunder.

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[2] The Communities are Allendale Township, City of Belding, City of Cadillac, City of Cedar Springs, City of Coldwater, City of Coopersville, City of Gladwin, City of Grayling, City of Ionia, City of Lake City, City of Manistee, City of McBain, City of Otsego, City of Plainwell, City of Reed City, City of Wayland, City of West Branch, Grand Haven Charter Township, Holland Township, Huron Charter Township, Leighton Township, Park Township, Pentwater Township, Richmond Township, Robinson Township, Springs Lake Township, Sturgis Township, Tallmadge Township, Village of Howard City, Village of Nashville, Village of Sparta, Village of Spring Lake, Whitewater Township, Yankee Springs Township, and Zeeland Township. Each community has retained the same counsel to assist it in regulating C-TEC's basic cable service rates and in filing complaint forms with this Commission relating to cable programming services. Mr. O'Malley is on the Steering Committee which assists the communities as they informally cooperate on these and other cable matters.

1. Continental Letter: A good example of attempted evasion are the attached letters which Continental Cablevision has sent to many of its franchising authorities in Michigan, consisting of a letter from Cole, Raywid & Braverman and a form cover letter from Continental. The text of the letter from Cole, Raywid & Braverman is as follows:

> "This letter will explain the operation of the Federal Communications Commission's "certification" rules and the practical reasons why a franchising authority might wish to delay certification of basic rate regulation authority.
>
> Although local franchising authorities may seek certification as early as June 21, 1993, there is no deadline for doing so, and no rights are forfeited through delay. When a franchising authority obtains certification (which is essentially automatic within 30 days of filing), it can always reach back to June 21 and award refunds from that date for up to one year of rate excesses (if any). Thus, a franchising authority which filed for certification in January, 1994, and received an operator's Form 393 in March, 1994, could reach back in say, April, and refund all rate overcharges from June 21, 1993, to the date of the order.
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> During the delay (prior to certification), a franchising authority has its maximum regulatory flexibility. It can obtain all of the FCC's benchmark data and calculate the Form 393 rate as though it were in formal proceedings. It may review informal cost of service studies. It may agree to negotiated settlements, such as using some equipment charges to subsidize lifeline or senior discounts.
>
> However, once a franchising authority certifies, it loses that flexibility. It is bound to follow FCC rules -- all 540 pages of them -- and cannot informally "settle" a rate case. It must go through the process under FCC procedures, which requires public participation and will add to the cost of administration of the franchise. Even when it issues its final order (with which it is presumably satisfied), that order is subject to appeal to the FCC by any subscriber who participated in the rate process. And once certified, there is no provision for de-certification except one which would have the FCC take over all rate control, including control of basic. Thus, in a practical sense, certification reduces a franchising authority's options.
>
> It is not the case that a cable operator would be free to raise rates or alter services without checking if the rate freeze expires August 3 and a city is not certified. Rate and channel changes must be preceded by 30-day notice, during which a city could certify. If the changes were at all objectionable, rates could be controlled by "reaching back" to June 21 for

refunds. As to channel changes: even if a city is certified, it is not authorized to prevent the retiering and restructuring of service tiers or to select

described in the letter. Even though some of these letters were sent out before NCTA's Petition for Reconsideration was filed, it is inconceivable that Continental (the third largest cable operator in the country) and that Cole, Raywid & Braverman (one of the leading law firms representing cable operators) were unaware of this challenge.

-- The letter is misleading because it does not point out that the one year reach back provision does not apply to rates for customer programming services.

If the Commission does not allow communities to generally initiate cost of service regulation for cable operators, it should do so under its authority to prevent evasions of the Act. See Act, § 623(h). Such a remedy is appropriate where operators such as Continental have provided misleading or incorrect information to franchising authorities or otherwise attempted to evade the Act. Such a remedy is appropriate for such egregious behavior.

Please note that only this Commission can reign in this type of behavior by Continental and other unscrupulous cable operators: Franchising authorities served by Continental that are sophisticated enough to see through letters such as this will disregard them and act promptly so as to be regulating rates by November 15. This will prevent Continental from raising rates up to the benchmark. But unsuspecting communities which take the letters at face value will not learn the truth of the matter until it is too late. So only this Commission can act to remedy the problem and deter such actions in the future.

And this Commission cannot underestimate the magnitude of the problem: Continental is the third largest cable operator in the country. Nearly 3 million homes receive their cable service from Continental alone.

Congress and the public have been critical of this Commission for delays in implementing the Act. Regardless of the merits of such criticism, it will be compounded if late this fall operators such as Continental raise their rates throughout the country, facts such as those shown above become public, and it turns out this Commission was aware of them, but asleep at the switch. The Cable Act was intended to reduce rates. This Commission has to take action to prevent its rules being evaded to raise rates.

As an alternative to the position set forth by King County, Washington, Michigan Communities therefore respectfully suggest that this Commission modify its rules to expressly provide that a franchising authority or this Commission can on their own initiate

cost of service regulation of a cable operator if the cable operator has attempted to evade the Act or this Commission's rules, such as by misleading or deceiving the community. The definition of misleading and deception should be similar to Securities and Exchange Commission Rule 10b-5 which has become a widely accepted standard for what is misleading or deceptive:

> "It shall be unlawful for any person, directly or indirectly...to make any untrue statement of a material fact or to omit to state a material fact necessary in order to make the statements made, in light of the circumstances under which they were made, not misleading."

17 CFR §240.10b-5

As to basic cable service, communities should be allowed in the first instance to make the preceding determinations and complete cost of service proceedings, with appeals to this Commission. Any rates so set should be retroactive as much as is necessary to undo the harm caused by the evasion so that the cable operator cannot benefit from its wrong doing. And if the franchising authority conducts such a proceeding, then, upon complaint by the municipality, this Commission should be required to set rates for customer programming services on a cost of service basis, retroactive to the same date.

The cable operators have abundantly indicated their dislike of cost of service based regulation. Such dislike indicates that it can act as an effective and legitimate deterrent to evasions of the Act and Rules.

2. N-Com Letter: A second example of misleading information is set forth in the attached letter of July 6 from N-Com Holding Corporation to the Village of Clinton, Michigan (population 2,475). N-Com is an MSO generally operating under the name of "Clear Cablevision" which serves a number of small communities in southeast Michigan.

On June 7, the Village of Clinton adopted a resolution authorizing and directing its manager and attorneys to file complaint forms with this Commission, to apply for certification and the like. The N-Com letter responds as follows:

> "I am writing in response to the cable rate resolution that the Village Council adopted on June 7, 1993. That resolution is facially inaccurate. The resolution states that Clear's cable rates "violate the FCC regulations." However, the resolution was passed weeks before rate regulation was to have gone into effect on June 21st, 1993. (The FCC has now postponed the effective date of rate regulations until October 1, 1993.) Obviously, Clear cannot be in violation of regulations that are not yet in effect. Moreover, the Village's position that Clear is in violation of FCC regulation [sic] runs directly counter to the most fundamental notions of due process since such position was taken without any hearing or request for information from Clear (as required by the new regulations) that could demonstrate (one way or another) what Clear's costs and therefore what its rates should be under the FCC's announced regulations."

This paragraph is notable for the following inaccuracies:

-- The Commission's May 3 Report and Order specifically does <u>not</u> require a franchising authority to conduct a due process hearing or request information from a cable operator prior to filing a complaint with this Commission about customer programming services. See Paragraphs 337 to 339 of the Report and Order, especially Paragraph 339 and footnote 832. There the Commission expressly said that it will apply the same minimum showing requirements to complaints filed by franchising authorities as to individual subscribers. See text of footnote 832.

-- This Commission's regulations do not require (and, cable operators will doubtless contend, do not allow) franchising authorities to generally compel production by cable operators of cost information outside of the cost of service context.

-- Finally, N-Com/Clear's position appears to run afoul of the division of jurisdiction between this Commission and franchising authorities. The kind of hearing it professes the Report and Order requires comes perilously close to requiring (if it does not achieve) rate regulation of customer programming services by a franchising authority.

Counsel for the cable company, Wilmer, Cutler & Pickering (a large Washington law firm) was copied on this letter. Whether they drafted it or only received it after the fact is unclear.

Nevertheless, small communities (such as the Village of Clinton) can easily be buffaloed by letters such as the attached, so that they never file a complaint about customer programming services or are delayed for substantial periods of time. Either result accrues directly to the financial benefit of the cable operator, given that rate regulation of such services starts only when a complaint is filed with this Commission.

Again, only this Commission can rectify this kind of evasion. Communities that are taken in by it will either not file with this Commission or will file extremely late. Communities which are aware that the letter is incorrect will go ahead and file any way and this Commission will be none the wiser.

B. Price Caps/Rates Below the Benchmark: Michigan Communities oppose the position of the National Cable Television Association that systems with rates below the benchmark may increase their rates up to the benchmark. See NCTA Petition at Summary, second page, third item (summary pages are unnumbered) and page 8 at and including footnote 14.

From preliminary analyses provided to Michigan Communities, it appears that 20% to 30% of all subscribers are served by cable systems whose rates are below the benchmark.

Note that this percentage is of subscribers -- not cable systems -- because the systems with rates below the benchmark appear to generally be the large systems in urban areas. Small rural systems who have large numbers of franchising authorities (but modest numbers of subscribers) tend to have high rates, generally above the benchmarks.

The Commission's rules provide that unless a community is regulating basic rates by November 15, for practical purposes the cable operator is able to permanently increase rates up to the benchmark level: The franchising authority is powerless to return basic rates to their preceding level. This Commission is powerless to act unless a complaint has been filed by November 15. So for communities with rates below the benchmarks, this Commission has created a 15 day window to file for certification to regulate basic rates -- if such a community files with this Commission for certification after October 15, it cannot complete the process so as to be regulating rates by November 15 and rates can permanently be raised.

This rule is a trap. It should be abolished by the Commission such that communities or this Commission may reduce rates to the lower of the benchmark amount or the amounts actually charged by the cable operator on September 30, 1992. As the letters from Continental Cablevision illustrate, cable operators are doing their best to try to make sure that communities miss the November 15 deadline. Hundreds of millions of dollars per year

Alternatively, if this Commission does not adopt the "lower of" approach at minimum, it has to greatly extend the time period in which communities with rates lower than the benchmark can file for certification -- two weeks plus a day is simply not enough, particularly given the misinformation deliberately being provided by cable operators.

C. Rate Regulation Agreements: King County, Washington and others address the issue of communities entering into rate regulation agreements with cable operators. As noted above, this Commission has ruled that such agreements are invalid. Yet at least one Commission staffer, Continental Cablevision, and others have said that communities can and should enter into such agreements. However, Robert Corn-Revere of the Commission staff has been quoted in the trade press to the contrary.

The Commission needs to resolve this dispute. Michigan Communities pose the following questions:

In many states, rate regulation is a legislative and not a judicial or contractual activity. One of the fundamental rules on the legislative powers of municipalities (and presumably of this Commission) is that one commission cannot bind future commissions. For example, one city commission cannot pass an ordinance barring future commissions from enacting ordinances, modifying ordinances, or the like.

So a rate regulation agreement in many states presumably is a legislative act that cannot validly bind future commissions. But if this Commission intends such agreements to be binding upon municipalities, it is becoming involved in a Federal/state relations area that is complicated, difficult constitutionally and very sensitive because it is attempting to confer powers on municipalities which state law often withholds.

If such rate agreements are allowed, do they cover basic cable service, cable programming services or both? Presumably they have to cover both because this

Commission has said that it has set up a unitary rate regulation scheme for both basic service and customer programming service. If so, who is empowered to enter into such agreements on behalf of this Commission? Can franchising authorities bind this Commission or can only this Commission do it? If the latter, do they bind future Commissions?

How can such agreements be squared with the clear intent of the Act for public input and participation and (in the case of basic service) the right of interested parties to present their views and appeal to this Commission? What notice must be given to the public and (by this Commission) to franchising authorities? No notice requirement would run directly against general principles that government be conducted in the sunshine and raises a specter of "secret deals secretly arrived at."

D. Pass-Throughs: Local Governments (NATOA) and King County, Washington have opposed the Commission's rule on the pass-through of external costs and franchise requirements. NCTA has requested that the pass-throughs be broadened to include the costs of rebuilding and upgrading cable systems.

Michigan Communities support the positions of Local Governments and King County and oppose the position taken by the NCTA. In this regard, this Commission should be aware how its rules are being portrayed to communities at the present time. Specifically, this Commission should know that cable operators in their dealings with municipalities have effectively indicated that they are going to turn the Commission's "price cap" regulation into "price floor" regulation by making most major costs "pass-through's". The Commission should resist such attempts and modify its regulations accordingly -- otherwise its attempts to simplify rate regulation are for naught.

Michigan Communities have learned this because some of them currently are in franchise renewal negotiations with cable operators. The cable operators have taken the position that under the Report and Order essentially all changes in or additions to franchise requirements are automatic pass-throughs.

Cable franchises average around 15 years in length, with some as long as 30 years. Fifteen year franchises that are currently expiring thus generally were negotiated in the late 1970's. Thirty year franchises were negotiated in the 1960's -- while Presidents Kennedy and Johnson were in office and cable was in its infancy. In each case, such franchises were developed for a different era when cable was much different than it is today. As a result, most franchises that are being renewed contain few of the requirements of a good modern franchise. This is especially true of smaller communities where even franchises issued within the last few years are often only 2 - 3 pages long with few (if any) requirements on the cable operator. Thus, for small communities, almost any provision of a new franchise could be argued to be an "additional requirement".

The most extreme situations occur in the 5% - 8% of municipalities where there is no current franchise, either because there never was one or because it expired and was never renewed. In such situations, if and when a franchise is agreed to, presumably the cable operators will contend that all its requirements are new and hence are additional costs entitled to a pass-through. And the cable operators will have obvious incentives to make as much as possible a "franchise requirement."

The following are some current examples of the preceding. As a part of their franchise negotiations, many of the Michigan Communities have negotiated or are negotiating customer service requirements that are generally modeled on those of this Commission, but with adaptations to local circumstances (normal business hours and the

like). The cable operators have agreed to many of the suggested changes and in some cases, suggested more stringent standards where their current policies were stricter than those of this Commission.

But the cable operators have essentially told the communities that anything that is in a new franchise on customer service is an automatic pass-through, even if it merely codifies the cable company's existing practice, so long as there was no identical provision in the prior franchise. As noted above, because most franchises being renewed are 15 - 30 years old, most contain no provisions analogous to those in this Commission's (or other) customer service standards. This emasculates the Commission's customer service regulations and the directive from Congress to improve these nationwide. And the cable operators apparently will contend that communities cannot even review the pass-through dollars to make sure that they are in fact for "franchise requirements" -- which is not a clearly defined term in the Report and Order.

As another example, most modern franchises to protect subscribers contain provisions to the effect that the cable operator will comply with applicable federal, state, and local laws. Some (not all) older franchises had such a requirement and even here the cable operators will presumably contend that the "requirement" has changed whenever the "applicable law" (state, Federal, or local) is added to or becomes more stringent. So now for practical purposes, most costs of complying with this Commission's technical standards, SEC requirements, local zoning laws, state laws of any description, tax laws, social security payments and the like are pass-throughs. If such contentions succeed, for practical purposes the Commission's "price cap" has become a "floor."

Another opportunity for abuse is if the cable operator can word a franchise such that it "requires" the operator to do something. If so, the operator will claim it can pass through

the costs of the "requirement." An illustration of how this can be abused is the following: Some of the small Michigan communities served by Tele-Media Corporation reported that when their franchises came up for renewal, Tele-Media simply delivered a new franchise, told them they had a few weeks to approve it, and said that if the community did not sign within that period of time, cable service to the community would be cut off! That is an extremely rough negotiating tactic and it is one that small communities -- with few or no full-time employees, and none knowledgeable on cable -- have great difficulty confronting. The communities in question signed the franchise as delivered to them. This illustrates how cable operators can use similar hardball tactics to effectively circumvent rate regulation by forcing communities to sign franchises that have been carefully drafted by the cable operator to make most significant costs "franchise requirements" and hence automatic pass-throughs.

Finally, NCTA argues that system upgrades and rebuilds have to be pass throughs. This makes a mockery of the Commission's price cap regulations. As with most utilities, the capital costs of a cable system are the single largest cost in the entire operation.

These statements by the operators are an excellent example why the Commission should not allow the pass-through of system rebuilds or other significant capital costs without a cost of service proceeding.

The cable companies claim that the cost of system upgrades should be flowed through in part because they provide for "innovative services". Translated, this means that the cable companies want the captive cable customer to subsidize other services that are not profitable on their own. This is a clear social waste. If the so-called innovative services are worthwhile, they will attract the capital on their own. The captive cable customer need not subsidize them.

Finally, Michigan Communities urge that if the Commission retains any element (which it should not) of "franchise requirements" for public access, franchise fees, franchise requirements or otherwise as an automatic pass-throughs that it has to amend its regulations to give franchising authorities the following limited relief: It has to give them the ability at any time to unilaterally modify existing franchises to eliminate or reduce such "requirements." Such a cost reduction measure can hardly be objected to by the cable operators (although they probably will), will benefit subscribers and is a simple and effective means for lowering rates and preventing the potential abuses outlined above.

E. Small Systems: Michigan Communities oppose the request by the Coalition of Small System Operators and the Community Antenna Television Association, Inc. in their petitions for reconsideration that small cable systems should not be tightly regulated or should be regulated under entirely different substantive rules than larger systems. The residents of small communities, if anything, need more protection than the residents of large communities.

First, rates often exceed costs more in small communities than large ones. This is because in small rural communities, cable is often the only viable source of television signals. At most, three to six fuzzy pictures may be available with a rooftop antenna. Some of the Michigan Communities have this situation where the only realistic options for a quality signal are the VCR or the satellite dish. As a result, small cable systems overcharge even more than their urban brethren, due to "what the market will bear" pricing leading to higher rates because the options are fewer.

That small cable systems are overcharging even more than larger systems is supported by three facts: The rates charged by small systems in general appear to be higher than those of larger systems; Preliminary comparisons done by municipal cable consultants of the rates currently being charged by various Michigan cable systems versus the benchmarks generally show that the systems that exceed the benchmarks by the largest amounts (25% to 30%) are small systems; The staff of the Michigan Public Service Commission (MPSC) advises that in its rate regulation of telephone systems, the small systems with very few access lines were generally extremely profitable, such that rate cases generally had to be initiated by the MPSC to reduce rates to appropriate levels.

Second, the cable operators claim that small systems don't overcharge and thus need less regulation because they are often owned by "friends and neighbors". This is incorrect--the owners generally are not neighbors and they certainly aren't friends. Most of the small systems are not locally owned -- they are owned by corporations in other states. C-TEC is a good example: It has approximately seventy systems in Michigan with a total of approximately 140,000 subscribers. Take out its five largest systems and the average number of subscribers per system is in the 1,000 range with many below it. Yet C-TEC is a large, publicly-held company headquartered in Dallas, Pennsylvania with substantial

interests in cable (250,000 subscribers in several states), cellular phones and conventional telephone (Commonwealth Telephone of Pennsylvania). TCI has one small system directly in Michigan (Northport -- total subscribers 256) and through its Bresnan Communications affiliate has several additional small Michigan systems with less than 1,000 subscribers. And Midwest I Cable Systems, Inc., a company headquartered in Martinsville, Indiana, has 219 systems in eight states (34 systems in Michigan) with a total of 21,168 subscribers. Simply math shows it has less than 100 subscribers per system. (All data from 1993 Cable and Television Factbook). These examples could be multiplied. So much for the cable operator's claims that due to local ownership there is restraint on pricing.

Some cable operators have told Michigan Communities that many of the small cable systems were "built to be sold, not to be operated." This is shorthand for a person getting the franchise in a local area and putting a system together with chewing gum and bailing wire with the intent of immediately selling it and turning a quick profit.

But some of the entrepreneurs who did this in the late 1980's and early 1990's found that the sellers' market had dried up -- they were stuck and not able to unload the small systems they had built. So entrepreneurs who had made their money by selling systems suddenly found that they were stuck as long term operators. The large cable markets already having been built, the entrepreneurs and systems who were left in this situation were predominately small systems in small communities.

There is no reason to carve out a special set of rules for these would-be cable tycoons of rural America. They made money on some of their transactions. There is nothing in the Constitution or Cable Act that guarantees them special rules on their last few systems just because they could not sell for what they hoped for and ended up having to operate the system.

The Michigan Public Service Commission (MPSC) regulates (or in the case of telephone companies, until recently regulated) small telephone and small private water companies that predominantly serve the same types of communities served by small cable systems. The MPSC indicates that it uses the same cost of service rules for these enterprises as for large utilities, but that as a practical matter the regulation is somewhat more relaxed and streamlined due to the small sums at stake and small amounts of data needed. The MPSC also indicates that these companies all tend to use the same law firm or accounting/engineering firms for their filings, which reduces costs.

The same can and should be expected to occur with small cable systems, for the same reasons. Please note that small communities (which are the communities generally served by small cable systems), often have at most one full time employee, and in the case of small townships have no employees, and are thus unlikely to engage in extensive, costly procedures for cable rate regulation.

Finally, in many areas in Michigan, small communities are joining together for rate regulation where they are served by the same cable system (or by different systems all owned by the same MSO). They are doing this for a simple reason: Efficiencies and cost reduction, which should lead to reductions in the cost of regulation for the cable operators as well.

For these reasons, Michigan Communities urge that the request for exemptions, special treatment or different rules for small cable systems be denied.

F. Municipal Systems: NCTA attacks this Commission's use of data from Paragould, Arkansas and other municipal systems in computing benchmark rates. The following specific items show that NCTA's claims are without merit.

First, the attached letter from the Larry Watson, the General Manager of City Utilities in Paragould, Arkansas shows that NCTA's "analysis" did not even use the right date for the year the municipal system started operation. Nor did it use the actual costs to construct the two cable systems whose profitability the "analysis" purports to compare. Mr. Watson's letter describes the history of their system and comments as follows:

> "Our municipal system started operation a little more than 2 years ago - we started in April, 1991. The City did this because we were very dissatisfied with the rates and service from our existing cable operator, a subsidiary of Cablevision Systems, Inc. In order to get into the cable business, we had to have special legislation pass the Arkansas legislature.
>
> The FCC should know that this legislation would not have passed but for the strong support of then Governor Bill Clinton. The governor has always been a strong supporter of our system. He has told me many times, 'Larry, I am delighted we got that bill through to allow you to go into the cable business. My only disappointment is that other communities have not followed your lead to set up their own municipal cable systems.'
>
> The Governor supported our efforts because he knows that municipal systems provide quality service at reasonable rates. And these rates are not subsidized by or other operations.
>
> The economic analysis attached to the NCTA's filing and its conclusions are incorrect. The figures used in it for such basic factors as the cost to build our system and the initial year we started operation are wrong - and not by a little, by a lot. These errors aid their incorrect conclusion that we're losing lots of money. I noticed that the consultants admitted they didn't use the true numbers: They said they didn't use the actual cost to build our system, but instead their estimate of its replacement cost.
>
> We built the system for a lot less than the figure they give for replacement cost. I assume the reason they used replacement cost for us was because if they used our actual cost to build our system, they'd have to do the same for our private competitor, Paragould Cablevision, which has been here for nearly 30 years, and that would show that the private company is making money hand over fist.
>
> Another error is the study's failure to use our actual debt service figures - these are publicly available, why didn't the consultants use them? And their statements about $60 per home tax are wrong. An assessed value of $50,000 would pay a tax of $27.00.

Let me explain this tax - because we are a startup operation competing with an existing cable company, we had to have some assurance that we could meet our costs during the first few years when we had few customers. Our citizens, who in effect are our shareholders, approved the tax to help in this regard. Our cable system has been doing better than our projection, and although we had to draw on the tax in the first year, it was well below the $60 level and is declining.

I don't see how this support we get from our citizen owners during our startup phase is any different from the support a private company would get from its owners to cover the negative cashflow during startup. Nobody makes money from day 1.

Finally the consultants say (or suggest) they got their data from us. They didn't. That's obvious in part from the mistakes in their figures. And as manager of the city's utilities any request for data would have come to my attention, and there was none."

Finally, Mr. Watson's letter points out that each of the city's utilities are run separately (none subsidize the others) and NCTA's conclusions both on this point and on the sums being lost by the Paragould system are wrong. So much for NCTA's "analysis" of the cable systems in Paragould.

The attached letter from Larry Hobart, the Executive Director of the American Public Power Association covers additional points. APPA's 2,000 members are municipally-owned (city owned, county owned) electric utilities which provide 15% of the U.S. population with electricity. About 40 APPA members own and operate municipally-owned cable systems. Mr. Hobart points out some major errors in the NCTA's petition as follows:

"I have to take issue with NCTA's statements that municipal systems "are extremely unlikely to cover costs plus a reasonable profit" because they "typically are subsidized by the municipality." This statement is not true.

Municipally owned utilities (electric, water, sewer, cable) are virtually always run as self-liquidating enterprises which cover their costs. Subsidies, if there are any, are typically <u>from</u> the utility <u>to</u> the city general fund -- not the other way around. Some of the reasons for this are financial -- cities nationwide face major problems -- they generally cannot afford subsidies. And municipalities must issue bonds to get the capital to build utility systems. Wall Street investors legitimately demand that costs be properly segregated

and that no cross subsidization occurs in order to have an accurate picture of the financials of the utility and to provide reasonable assurance that the bonds will be repaid.

NCTA has skewed the sample of municipal utilities which it mentions in its filings to municipal cable systems that have been created within the last two or three years. This is true of Glasgow, Kentucky: Paragould, Arkansas: and Elbow Lake, Minnesota. No startup enterprise, public or private, can be expected to earn money from day one. But to extrapolate from these startup situations to well-established municipally owned cable systems as a whole is incorrect."

So much for NCTA's claim about "cross subsidies".

Both Mr. Hobart and Thomas Daly, the General Manager of the municipally-owned cable system in Wyandotte, Michigan commented in letters on matters relating to rates and the fact that municipally-owned utilities provide a useful competitive check on utility rates by so-called "benchmark competition" according to the courts, Congress, economists and others. As Mr. Hobart said:

"The NCTA and FCC should be aware that municipally owned utilities have always been viewed by the courts, Congress, Federal Energy Regulatory Commission and economists as providing a useful competitive check on utility rates -- so-called benchmark competition. This is because municipal utilities, due to the lack of conflict of interest between shareholders and customers, the high efficiency with which they operate (shown by repeated studies and the absence of excessive salaries) provide a useful comparison as to what the rates of privately owned utilities should be. This is the theory of "yardstick" competition. Even though two utilities which as natural monopolies do not compete head to head, the low rates of a municipally owned system (due to the efficiencies and other factors just mentioned) provides a check or "yardstick" for the courts and regulators to use in setting the rates for adjacent privately owned utilities.

This benchmark competition approach is particularly appropriate in the cable area where municipally owned utilities built their systems, operated them, paid off their debt, and kept rates low. This is in marked comparison to privately owned cable companies which have simply sold, resold, and sold their systems again with each purchaser increasing rates to cover the cost of the purchase price, generate excessive profits and the like. This would not happen if cable companies were subject to effective competition. Thus, the rates for municipally owned cable systems give a very good indication of what the rates of private cable system would be if they faced true competition."

Mr. Daly's letter notes (see the letter and rate sheet attached) that for $12 they offer 48 channels, including remotes, free installation, converter box, and program guide. His comments on their history, why their rates are low compared to other operators and on cross subsidization are as follows:

> "We started providing service in the city in 1983 and currently service approximately 10,000 homes - a penetration rate of 75%. You will note this penetration rate is very high by industry standards. This is because we have kept our rates low. For $12.00 today we offer 48 channels which includes remote, free installation, convertor box, and program guide. See our rate sheet, attached.
>
> We are very proud of our municipal cable system. One of the people that appears on it frequently is our local Congressman, John Dingell. I know he is proud of it as well and has worked with us to make sure that our system is not unduly adversely affected by the provisions of the 1992 Cable Act. Congressman Dingell has been a strong supporter of our system throughout its existence and we appreciate that.
>
> As with most municipally-owned utilities nationwide, each of our own utilities is run as a self-liquidating operation. When our cable system started out in 1983, its rates were the same as those of privately-owned cable systems in adjacent communities. Over time, as the private systems were sold and resold, they kept increasing their rates. We did not because our rates were more than adequate to cover the cost of the debt issued to build our system plus all its operating costs. Our external debt has been retired, and we are planning a fiber optic overbuild of our system.
>
> Claims that the cable system is subsidized by the city are wrong. We pay franchise fees of approximately $275,000 per year to the General Fund of the City, and we support our two public access channels. In fact, the cable system recently was able to give a $35,000 gift to the city to help public sector programming. The cable system contributes to the city."

The attached letter from the Glasgow Electric Plant Board shows that the private cable operator there has expressly said that it is <u>not</u> losing money even at <u>lower</u> rates than it is now charging. Mr. William Ray, the Superintendent of the Glasgow system said as follows: